

IN THE DAVIDSON COUNTY CHANCERY COURT  
AT NASHVILLE

SENTINEL TRUST COMPANY, and its )  
Directors, Danny N. Bates, Clifton J. Bates, )  
Howard H. Cochran, Bradley S. Lancaster, )  
and Gary L. O'Brien, )

Petitioners, )

v. )

No. 04-1934-I

KEVIN P. LAVENDER, Commissioner of )  
the Tennessee Department of Financial )  
Institutions, )

Respondent. )

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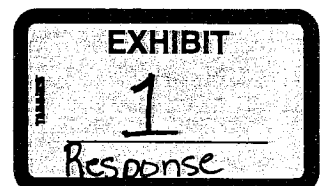
**AFFIDAVIT OF WADE McCULLOUGH**

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STATE OF TENNESSEE)  
COUNTY OF DAVIDSON)

I, WADE McCULLOUGH, having first been duly sworn, state to the Court as follows:

1. I have been employed with the Tennessee Department of Financial Institutions since April 1, 1986. I began as a Financial Institutions Examiner Trainee, and was eventually promoted all the way up to an Examiner IV with the Department. I am currently an Examiner/Trust Specialist with the Department and have held this position since May 1, 1999. I am also a Certified Financial Examiner (CFE) through the Society of Financial Examiners and have been so for at least ten years. I am also a Certified Examiner-In-Charge ("CEIC") through



the Conference of State Bank Supervisors (“CSBS”), the national association of the various state departments that regulate banking and financial institutions.

2. In June, 2003, the Department began an examination of Sentinel Trust Company under the direction of Vivian Lamb, Program Administrator-Trusts for the Department. As an Examiner/Trust Specialist, I assisted Ms. Lamb with this examination.

3. On March 19, 2004, the Department was provided with a copy of the audit report of Sentinel Trust Company for the period ending December 31, 2002, prepared by Kraft Bros. CPA. In that report, Kraft identified approximately \$9.4 million in fiduciary account receivables, of which approximately \$7.5 million resulted from expenditures Sentinel had made in connection with defaulted bond issues and related unreimbursed costs and expenses. Kraft stated in the report that the company’s records had been inadequate for them to satisfy themselves as to the existence, amount or collectability of those receivables and, due to the materiality of this issue, Kraft declined to give an opinion as to Sentinel’s financial position as of December 31, 2002.

4. On March 22, 2004, I, along with the Examiner-in-charge (“EIC”) Vivian Lamb, and Trust Specialist Bruce Allen, returned to Sentinel’s principal offices in Hohenwald, Tennessee, to review additional records and information. Based upon the the records provided at this visit, I then conducted a reconciliation of Sentinel’s fiduciary cash position as of December 31, 2003. To do this, I first ascertained Sentinel’s fiduciary cash position as reflected in both the AccuTrust and the Quickbooks systems. The accounts in these two systems were within a difference of \$2.00 — \$14,197,093 in AccuTrust and \$14,197,095 in Quickbooks. I then reconciled this amount (\$14,197,095) and the balance determined by Mr. Brewer (\$10,987,183), as well as the overdrafts on the defaulted bond issues shown in AccuTrust. My reconciliation of

Sentinel's fiduciary cash position showed a net cash shortage in the pooled fiduciary account of \$5,789,011 as of December 31, 2003. Mr. Brewer is an independent CPA, who had been hired by President Bates specifically to conduct a reconciliation of the cash balance in the pooled fiduciary account (the SunTrust account) as of December 31, 2002 and December 31, 2003.

5. I gave a copy of my reconciliation to President Bates. Then, on April 1, 2004, Vivian Lamb and I returned to Sentinel to meet with President Bates, and Beverly Horner, a Kraft Auditor, and two assistants. Directors Clifton T. Bates and Howard Cochran also attended this meeting. During the course of the meeting I specifically asked President Bates if he disagreed with my analysis and determination of a net cash shortage in the pooled fiduciary account of \$5,789,011 as of December 31, 2003. President Bates did not disagree with either, but instead, stated that this figure was close to the actual amount of the shortfall.

6. Furthermore, President Bates made no suggestion during this meeting that there were substantial fees earned by the company on the defaulted bond issues, but not yet posted on its accounting system, that would be available to replenish the shortfall in the pooled fiduciary account. President Bates also made no mention of the existence of any uncashed checks made payable to Sentinel for fees earned on the non-defaulted bond issues, which would also be available to replenish the shortfall.

7. I later attended a meeting the Commissioner and other members of the Department had with the Board of Sentinel and its legal counsel on April 30, 2004. During that meeting, President Bates admitted that his most recent calculations showed that the net cash shortage in the pooled fiduciary account had increased to approximately \$7.25 million, but that this figure fluctuated daily. Again, at no time during this meeting, did President Bates, or any

other member of the Board, suggest that there were substantial fees that the company had earned on the defaulted bond issues, but had not posted on its accounting system and that were available to replenish the shortfall in the pooled fiduciary account. President Bates also made no mention of the existence of any uncashed checks made payable to Sentinel for fees earned on the non-defaulted bond issues, which would also be available to replenish the shortfall.

8. After the Commissioner took possession of Sentinel on May 18, 2004, I was assigned by the Commissioner to assist the Receiver, specifically in analyzing Sentinel's records to determine its true financial status, and with the receivership in general. During the course of reviewing Sentinel's records in the vault in the Hohenwald office, we discovered \$861,107.11 in bond principal and interest checks Sentinel had issued to bondholders. These checks are for: (1) interest payments already due or (2) matured bonds for which demand has yet to be made. To date, we have received demands totaling \$105,000 for the bond principal checks.

9. In analyzing Sentinel's records to determine its financial status, I have spent a considerable amount of time reviewing Sentinel's accounting systems. Sentinel currently uses two different accounting systems — AccuTrust and Quickbooks. AccuTrust is a single entry system, *i.e.*, it only allows for the entry of an item as either income or expense. Quickbooks is a dual entry system, *i.e.*, for each debit recorded there is a corresponding credit and vice versa). It is also an "active" accounting system, in that it allowed President Bates to pay monies out of the corporate and trust accounts. President Bates has consistently represented to the Department, however, that AccuTrust is the company's official fiduciary accounting record. Records beginning with December 31, 1999 are reflected on both systems. Before these two systems,

Sentinel had utilized TrustNet, a DOS based system, for its fiduciary accounting, and AccuGen, a Linux based system, for its general ledger accounting.

10. My review of the AccuTrust and Quickbooks systems shows that inconsistencies have existed between these two systems. My review also reflects that the balances in the two systems were not consistently reconciled with each other or with the bank statements. By the time the Commissioner took possession on May 18, 2004, the AccuTrust system reflected a total cash balance in the fiduciary account of \$10,280,912, while Quickbooks showed a balance of \$10,386,921. Moreover, the bank statement from SunTrust reflected a cash balance in that account of only \$2,472,928. In addition, the balance in Sentinel's Union Planters fiduciary account was only \$41,601. (There is no local branch of SunTrust in Hohenwald. Because of this, Sentinel had been using its corporate account at Union Planters to receive funds from bond issuers and then transferring them to the pooled fiduciary account at SunTrust. At the direction of their auditors, Sentinel set up a fiduciary account at Union Planters to now receive these funds.) By the time we issued our preliminary report to the Commissioner on June 15, 2004, the balance in both accounts had decreased to a total of \$2,410,063 as a result of checks written prior to May 18, 2004 being cleared.

11. My review and analysis of Sentinel's records also reflects that Sentinel has listed over \$1 million in accounts receivable ("AR") from a number of previously defaulted bond issues for which there is no documentary support. Each of these accounts currently reflects a positive cash balance in the pooled fiduciary account, which in most instances is in excess of the account receivable shown on Sentinel's records. In fact, Sentinel's records show that these bond issues should have had **\$2,015,388.83** on deposit in the pooled fiduciary account as of May 18,

2004. Sentinel's records further reveal that these expenses and fees have already been paid and that these bond issues currently owe no funds to Sentinel. A list of these bond issues, the amount of their AR and positive cash balance as shown on Sentinel's records, as well as where the fees and expenses have been paid is set forth in a schedule which is attached hereto as Collective Exhibit A and incorporated herein by this reference.

12. Also, I have determined that what Sentinel now lists in Quickbooks as "accounts receivable" are actually the "overdraft balances" on the defaulted bond issues. The Petition for Writ of Certiorari states that when expenditures on a defaulted bond issues exceeded the amount of cash on deposit with respect to that issue, management would classify the excessive payments as an "overdraft" in the AccuTrust system. My review of the records indicates that this statement is essentially correct. However, in my review I also discovered that on May 11, 2004, management transferred all but three of the overdraft balances in AccuTrust to the accounts receivable account in Quickbooks, thus excluding these overdrafts from the AccuTrust account records.

13. From my review and analysis of Sentinel's records, I have also identified a number of bond issues allegedly owing fees to Sentinel, which management capitalized and recognized at a time when none of these issues had a positive cash balance in the pooled fiduciary account. In other words, these accounts either had no funds on deposit with Sentinel or had "overdrafts". Specifically, on April 15 and 16, 2004, management recognized default fees against a number of bond issues for fees assessed in January and February, 2004. Management then transferred \$82,973.98 from the pooled fiduciary account at SunTrust to the corporate account at Union Planters. A list of these bond issues, the amount of fees assessed and their

account balances are attached hereto as Collective Exhibit B and incorporated herein by this reference.

14. I have also conducted a review of Sentinel's record to determine its net income from 1996 to May 18, 2004, the date of possession. Based upon those records, I have determined that Sentinel's total net income for the years 1996-2003 is \$1,370,149.04. This amount includes a \$575,000 court settlement paid by Sentinel as a result of management having been found in violation of its fiduciary duties, which the company was required to recognize as a one-time charge on its income statement in 2000. Without credit for this amount, Sentinel's total net income for 1996-2003 would only be \$795,149.04. A copy of the spreadsheet setting forth this information is attached hereto as Exhibit C and is incorporated herein by this reference.

15. Sentinel's records reflect that for the first four months of 2004, the company had a net loss of \$163,501.16. By May 18, 2004 when the Commissioner took possession, that net loss had increased to \$197,917. Included in this net loss position is the recognition of losses totaling \$100,522 in relation to two defaulted bond issues: Sullivan County, TN and Jose Eber Salons, Inc. Management had previously used funds out of the pooled fiduciary account to fund expenses relative to these defaulted issues and had recorded those funds as overdrafts. In April, 2004, management apparently determined that there would be no recovery on these two defaults and, therefore, recognized the loss on its income statement for that month. However, the recognition of the loss on the Jose Eber Salons bond was not recorded by management in the accounting of the overdraft-receivable balances. Additionally, management only recognized a loss of \$25,136 on the Jose Eber Salons bond, while its accounting records indicated that the actual overdraft-receivable balance was \$133,701.96. Since management had determined that

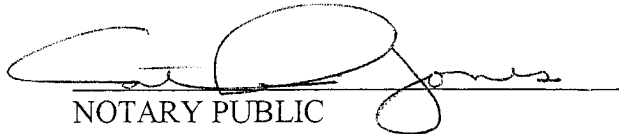
there would be no recovery on this bond issue, it should have recognized the full amount of the overdraft, which would have increased the company's net loss to \$306,482.96 as of May 18, 2004.

16. Finally, the Petition for Writ of Certiorari alleges that when the company had earned fees from its non-defaulted bond issues and periodic checks were issued to Sentinel, management retained some of those checks as uncashed in order to assure "adequate liquidity" in the pooled fiduciary account. The Petition further alleges that at the time the Commissioner took possession of Sentinel's properties, there was a total of \$2.6 million of these uncashed checks. I, along with the Receiver, members of the Receiver's staff and other members of the Department, have searched Sentinel's offices and to date have not found any evidence of these uncashed checks. Furthermore, since management did not regularly reconcile the balances in AccuTrust with the balances in Quickbooks or with the bank statement balances, there simply is no way for us to determine whether or not these checks actually exist and are in Danny Bate's possession or some other unknown location.

FURTHER AFFIANT SAITH NOT.

  
WADE McCULLOUGH

Sworn to and subscribed before me this 26<sup>th</sup> day of July,  
2004.

  
NOTARY PUBLIC

My commission expires: 5/29/2005